THE JOURNAL
OF
POLITICAL ECONOMY

OCTOBER—1908

THE ALDRICH-VREELAND ACT

I

It is just ten years since the *Report of the Indianapolis Monetary Commission of 1898* gave to the public a study of the evils in our monetary system, and proposed certain reforms. The dangers arising from the silver circulation and the steps for establishing the gold standard, brought forward by this report, were largely, if not fully, provided for in the Act of March 14, 1900. The recommendations for the gradual withdrawal of the greenbacks, however, in connection with a revision of the system under which national bank notes were issued, were not carried out. In the proposals for improving the system of issuing bank notes a careful study was made of the so-called asset-currency, as opposed to an inelastic bond-secured issue. That presentation in the *Report,* for the first time brought the subject before bankers and legislators for serious consideration. It has taken ten years for that leaven to produce any practical results. The plan was at first coldly received by the bankers; but in the bill drawn up by the Currency Commission of the American Bankers' Association, in the early part of 1908, and presented to Congress, all the essential features of the Monetary Commission Bill of 1898 were included; although the later bill was advisedly meant to be only a transition measure, and retained a partial bond feature as a compromise. Likewise, the bills introduced by Mr. Fowler, chairman of the House Banking Committee, were founded on the same general principle, although differing from the other plans in

simplicity and in the means for carrying out the change from the old to the new system. Finally the panic of 1907 pricked public feeling into a demand for additional legislation on banking; and the politicians became firmly convinced, especially in view of the coming presidential campaign of 1908, that this public opinion must be satisfied by some kind of legislation. The consequence was the Aldrich-Vreeland Act (H. R. 21871) of May 30, 1908. It is a curious compound of conflicting views, compromise, haste, and politics; but it is now the law of the land, and its provisions ought to be submitted to careful scrutiny.

II

The political considerations affecting the passage of the Act are not clearly explicable. The Republicans have played fast and loose with the money question in the past; and the Democrats have lost prestige, and two campaigns, by taking up silver. Neither party has been consistent.

In early days, the Democratic party—as in the time of Benton and Jackson—advocated the gold standard, and opposed a great central bank; but it forced the extinction of the Second United States Bank, largely because it had tried to exact redemption for the state bank issues in the south and west. At the close of the Civil War, the Democrats took up with the greenback craze, thus allowing their opponents to appeal to the business public as the champions of sound money. The Republicans passed the Act of 1869 strengthening the public credit, passed the Resumption Act of 1875, and resumed specie payments, January 1, 1879.

The victory over greenbackism and inflation was not an easy one; and when the Democrats introduced the silver mania as a substitute for greenbackism the Republicans wavered. The protectionists bought immunity by votes for silver; and Republicans helped to pass the Bland-Allison Act of 1878. Moreover, they were chiefly responsible for the Sherman Act of 1890, which was followed by a panic and the repeal of silver purchases in 1893.

It was this departure of the Republican party from sound monetary policy—on the ground of expediency in catching votes —which gave the opportunity to the Democrats under the leader-

ship of Cleveland to out-general their opponents. By a stroke of political genius Cleveland maneuvered the Democrats into the position of advantage formerly occupied by the Republicans, and restored to them their ancient advocacy of the gold standard. Then, for the first and only time since the Civil War, did the Democrats elect their candidates for president. Immediately thereafter a populistic wave overwhelmed the Democrats and carried them off to the desert of silver and bank hostility. Their opposition to the gold standard, and their ignorant attitude on banking legislation, lost them the confidence of the electorate.

The Republicans, however, went right only by accident and expediency. The errors of their opponents showed them the pitfalls to avoid; it was not an understanding of the monetary question, and a patriotic desire to give the business and industrial interests of our land a banking system best adapted to further domestic and international trade, which actuated the policy of the Republicans. They had been on the fence; and they finally got down on the gold side only because they saw the Democrats struggling in the brambles on the silver side. They deliberately used the money question as a means of retaining political power, and for years kept the business interests of the country on tenterhooks for the sake of party advantage. It was not the favor of the business public, but the populism and wildness of the Democrats on money, which kept the Republicans in power. In 1900 the latter were unwilling fully to establish the gold standard in the Act of March 14, 1900, by making our silver coins redeemable in gold, because they believed there was still a chance of preventing the discussion of the tariff, and retaining public support, by keeping the money issue open. This is the price industry pays to politics in a democracy.

And, now, when the panic of 1907 forced the temporary suspension of payments by banks from the Atlantic to the Pacific, and brought on the issue of clearing-house certificates, and clearing-house currency in default of ordinary forms of money, the party in power felt that the unthinking voters would charge it with responsibility for not having legislated in favor of an abundant circulation. The theory on which the supposed demand

for legislation was based is believed to be that the panic was due to a scarcity of money. Of course, this specious reasoning is nothing more or less than the argument of the greenbackers and the silverites. Yet with the politicians the point is not whether the theory is right or wrong; it is whether or not the theory is actually held by masses of voters who are to be cajoled. In connection with the measures taken by the Treasury to meet the effects of the panic we heard from the President and the politicians an emphasis upon the supposed aid rendered by the issue of enormous sums of currency. Even the sale of Panama bonds and 3 per cent. certificates was heralded by triumphant words of inflation as an addition to the currency. It matters little that these securities were not money; it was hoped to hoodwink the people. There seemed to be, in the matter sent out from Washington to the press, little understanding of the causes of the panic, and the performances of the Treasury were the crudest in our monetary history—and that is saying a good deal. Having no policy as to monetary reform beyond that of political expediency, it was not to be expected that the Republicans would treat banking legislation on its merits. Here is the milk in the cocoanut. No legislation is to be had solely because an understanding of banking principles directs a specific reform; the political leaders in power do not have sufficient courage to do what is really needed by the commercial public, provided enough whittlers on store-boxes at the country cross-roads have other views as to what should be done.

The Democrats, as usual, have taken the populistic attitude of urging the issue of all notes by the government, and the withdrawal of the issue-function from the banks. Thereby, they have fortunately given the Republicans a political reason for favoring some legitimate, or possible, basis for the issue of notes by the banks. The question is: what basis shall the Republicans adopt? That was the crux of the Aldrich-Vreeland Bill.

III

In the last session of Congress, following the panic of 1907, the demand for new legislation contained the crude expectation

that the law would prevent the possibility of future panics. This view was expressed both in a part of the press and in Congress, and showed little appreciation of the real causes at work in an inflation of credit. In the Senate, where the members of the Finance Committee were also the practical rulers of the Republican party, a stern opposition was early expressed against any form of "asset-currency," and this policy had the support of the President. Evidently, the politicians believed that the issue of notes by banks on other security than bonds would expose their party to attacks in the next campaign which they, in their general incapacity on banking questions, would not be able to meet successfully. They were so uninformed as not to see that elasticity, ready expansion of the currency in time of need, and lower rates of interest to borrowers would be popular issues with the people in any campaign. Also, no doubt, there was a conviction in the minds of many Senators that "asset-currency" was synonymous with "wild-cat currency" and involved the dangers of uncontrollable abuses by excessive issues. It is needless to say that those dangers do not inhere in any legitimate system of "asset-currency," as is amply proved by its use in the chief commercial countries of Europe; but it is interesting to note that leaders—ignorant of banking and openly flouting the advice of trained bankers—produced in the Senate Aldrich Bill a plan for notes issued on bonds of a kind as like those of "wild-cat" currency days as any two peas. Looking at the matter as politics, it is difficult to understand why the Senate stubbornly thought it possible to gain votes by antagonizing the very commercial bodies and banking interests who were most competent to judge of such matters. It is a matter of curious interest to know why there was political capital to be gained from urging a bond-secured system of note issues which had long been known to have been outgrown, rigid, inelastic, hurtful to country districts, and of little advantage to large city banks which make comparatively small use of the issue function. The bond-secured system lent itself to such easy and popular attacks that, as a political move, it proved a great blunder. When the Aldrich Bill came down from the Senate it was thoroughly riddled in the House

by the representatives of industry and banking who appeared before the Banking Committee; and in the House, which much more nearly represents the opinions of the public than the Senate, it was overwhelmingly defeated. One can scarcely avoid the conclusion that the Aldrich Bill represented only the stolid personal prejudices of a very few mistaken politicians, who held the reins of power.

On January 7, 1908, Mr. Aldrich introduced his bill (S. 3023), and it was reported out by the Committee on Finance with amendments, January 30, 1908. Later, before passing the Senate, some radical amendments were added, to meet the views of such men as Senator LaFollette (e. g. Sec. 11).

The original Aldrich Bill permitted a national bank, having an outstanding circulation, secured by United States bonds, to an amount not less than 50 per cent. of its capital, and which had a surplus of 20 per cent., to issue additional circulation secured by bonds other than bonds of the United States. These other bonds are as follows:

> Bonds or other interest-bearing obligations of any state of the United States, or any legally authorized bonds issued by any city, town, county, or other legally constituted municipality or district in the United States which has been in existence for a period of ten years, and which for a period of ten years previous to such deposit has not defaulted in the payment of any part of either principal or interest of any funded debt authorized to be contracted by it, and whose net funded indebtedness does not exceed ten per centum of the valuation of its taxable property, to be ascertained by the last preceding valuation of property for the assessment of taxes; or the first mortgage bonds of any railway company, which, in compliance with existing law, reports regularly to the Interstate Commerce Commission a statement of its condition and earnings, and which has paid dividends of not less than four per centum per annum regularly and continuously on its entire capital stock for a period of not less than five years previous to the deposit of bonds.

Notes secured by other than United States bonds could be issued, on the approval of the Secretary of the Treasury, to an amount, if railway bonds, equal to 75 per cent., and if other bonds, to 90 per cent. of their market value. The limit of notes issued by a bank, was the amount of its capital and surplus; and the total of this additional circulation issued by all the banks

was $500,000,000. In case of contraction, United States bonds could be withdrawn by the deposit of lawful money; other than United States bonds, by the deposit of lawful money, or national bank notes. The notes were to carry on their face a pledge of the United States that they would be redeemed on presentation in lawful money. A tax of ½ of 1 per cent. was levied on the notes, if secured by United States bonds bearing less than 2 per cent. interest; 1 per cent., if the United States bonds bear more than 2 per cent.; and 1 per cent., if the bonds are other than United States bonds.

The Aldrich Bill, as amended among other things to include bonds of Porto Rico and the Philippine Islands, and excluding railway bonds, passed the Senate (March 27) and was referred in the House to the Committee on Banking and Currency, March 30, 1908.

As opposed to this Senate measure was the Fowler Bill, reported from the Banking Committee to the House. The original Fowler Bill (H. R. 23017, Fifty-ninth Congress, Second Session) introduced December 20, 1906, in the main had the support of the bankers. This bill followed the general policy of the Monetary Commission of 1898, but proposed a gradual change from notes secured by United States bonds to notes secured by commercial assets. According to it, "National Bank Guaranteed Credit Notes," equal to 40 per cent. of the notes issued by a bank secured by United States bonds, and not exceeding 25 per cent. of its capital, could be issued without the deposit of any United States or other bonds. Such notes should pay a tax of 3 per cent. An additional amount of notes equal to 12½ per cent. of the capital could be issued by paying a tax of 5 per cent. The outside limit was the amount of the capital. The holder of these credit notes was to be a general creditor of the issuing bank. A guaranty fund of 5 per cent. of the credit notes was established, and all taxes on circulation were to be covered into this fund. Additional redemption cities were required.

In the last session of Congress (Sixtieth Congress, First Session) Mr. Fowler introduced another bill (H. R. 12677) January 8, 1908, and it was reported out by the Committee on

Banking and Currency February 29, 1908. In his later bill Mr. Fowler seemed to have lost the support of the American Bankers' Association; and, of course, the administration and the leaders in Congress who favored a bond-secured circulation, opposed. This measure went to extremes, and included many other than banking schemes. While some of the additions, omitting the guaranty of deposits, were meritorious, Congress and the public wished to act on only one thing at a time. This bill (H. R. 12677) urged the creation of not more than twenty Bank Redemption Districts, controlled by eight managers and a Deputy Comptroller, and within which each bank should select a redemption center for its notes. Its refusal of all compromise appeared in its allowing a bank at once to retire all its notes secured by United States bonds and replace them with notes, not secured by bonds of any kind, to a limit equal to its capital; provided the bank had arranged for the redemption of its notes in gold at a redemption center, and had deposited with the Treasury in gold, or lawful money, 5 per cent. of its notes, and 5 per cent. of its deposits, as guaranty funds. If the district managers approved, a bank might issue an additional amount of notes equal to 100 per cent. of its capital. Such notes would have a distinctive color, and state on their face that they were redeemable in coin and guaranteed by a fund deposited with the Treasury. After January 1, 1909, no notes secured by bonds were to be paid out. Banks were to pay 2 per cent. interest on government deposits, and to be freed from giving bonds as security for deposits. The notes to be taxed 1 per cent. In addition the measure contained provisions for a guaranty of deposits, for enabling national banks to do a trust business, for abolishing the independent Treasury System, and for the eventual retirement of the greenbacks.

It soon became evident that, while the House would pass a bill permitting a trial of commercial assets as a basis for note-issues, it was not ready to throw over all bond security; and, also that the House would not pass the Aldrich Bill. Hence, both the Aldrich and the Fowler Bills were impossible. Yet the political managers were firm in the belief that some banking

bill was obligatory in view of the recent panic. A caucus of the Republican party in the House appointed a committee, including Mr. Vreeland (New York) and Mr. Burton (Ohio) but excluding Mr. Fowler, the chairman of the Banking Committee, to frame the bill. Mr. Fowler had incurred the hostility of the administration and of the leaders of the House and Senate, and was officially ignored. This caucus bill was wrung from the politicians by force of events, not being based on any purpose to touch the real merits of the problem.

Two bills (H. R. 21810 and H. R. 21871) were introduced by Mr. Vreeland on May 11, and May 12, 1908. They differed only in slight matters, except that the later bill changed the words to be printed on the notes. Redemption by the United States was dropped out, and the words of the present act introduced. Knowing this measure to be inspired by those who had the power to enact it, its provisions are of importance: National clearing-house associations, made up of not less than 10 banks having an aggregate capital and surplus of at least $5,000,000 were created, to be managed by a board having one representative from each bank, and given the power to issue additional notes based on "any securities, including commercial paper, held by a national banking association," provided the given bank already had out notes secured by United States bonds to an amount not less than 40 per cent. of its capital. Notes were limited to 75 per cent. of the cash value of the securities, or of the commercial paper. These notes were a lien on all the assets of all the banks in the given currency association issuing the notes. The limit of the issues of any one bank was its capital and surplus; and the aggregate of the additional issues (not based on United States bonds) was $500,000,000. Banks must hold the same reserves behind the emergency circulation as for deposits: notes secured by 2 per cent. United States bonds to pay a tax of ½ of 1 per cent.; if bearing more than 2 per cent., a tax of 1 per cent.; if secured through clearing-house associations (i. e., on commercial paper, etc.) a tax of 4 per cent., increasing monthly by 1 per cent., until 10 per cent. is reached; these taxes to be covered into the general funds of the Treasury. Notes secured by United States

bonds could be withdrawn at a rate not exceeding $9,000,000 a month; if otherwise secured, no such limit was imposed. The wording on the notes was as follows:

> Such notes shall state upon their face that they are secured by United States bonds or other securities according to law, shall be certified by the written or engraved signatures of the Treasurer and Register, and by the imprint of the seal of the Treasury. They shall also express upon their face the promise of the banking association receiving the same to pay on demand, etc.

Whenever these notes were presented to the Treasury for redemption, they should be redeemed in lawful money. Finally, a National Currency Commission was to be appointed, having six senators, six representatives, and six others, to investigate "the causes of the recent financial crisis," and to make recommendations in a report by January 1, 1909. It is worth noting that in the final enactment the Commission was relieved from explaining the causes of the panic.

Mr. Fowler, not to be repressed, introduced his bill again, May 4, 1908, shorn of its extreme provisions. Accepting a requirement that a bank should already have notes outstanding secured by United States bonds equal to 50 per cent. of its capital, it could then issue 50 per cent. more, not secured by bonds; and in an emergency an additional sum equal to 100 per cent. of its capital and surplus, with the consent of district managers and the Comptroller. On January 1, 1909, however, all notes secured by United States bonds were to be canceled. The provisions for guaranty of deposits, trust business, abolition of the greenbacks and the sub-treasury were dropped.

This bill, favored by many, was rudely set aside and the Vreeland Caucus Bill was passed in the House by a large majority. The Senate refused to accept it, the Aldrich Bill was substituted, and the matter was finally referred to a conference committee of both Houses. After considerable struggle in conference, in which much of the Aldrich Bill was introduced into the Vreeland Bill, the Aldrich-Vreeland Bill was reported to both houses in the last days of the session, and hurriedly passed under

the party lash, May 30, 1908. It was passed before printed copies of the bill were distributed.

Like most political measures, which look both ways and try to conciliate conflicting interests, the Aldrich-Vreeland Act contains many inconsistencies. On the one hand, it catered to a supposed public opinion among the masses against "asset-currency;" and on the other hand, it aimed to win the eager support of the influential classes owning or marketing the great volume of financial securities. By inserting much of the Aldrich Bill into the Vreeland Bill in the Conference Committee, the bond interests evidently won a great victory. Therefore, in view of the evident desire to play politics and win the most votes, it is almost inconceivable that the exceptional favors to holders of market securities should have been regarded as good politics, especially as the measure alienated large banking and commercial interests.

IV

It is this Aldrich-Vreeland Act, emerging from such political conditions, which is now on the statute books, and it is important to know just what its provisions are. It is evident, from the start, that the haste with which it was pushed through Congress must have made careful legislation impossible. In some quarters,[1] it has been heralded as a great triumph of Republican monetary policy; and in other quarters it is regarded as bad in theory, and a cheat, because it was offered as a compromise to asset-currency advocates and yet too greatly minimized what it was said to offer. Certainly the law is a failure, if it was expected to quiet the urgent demand for banking reform; and the political gains are far to seek.

One evident purpose of the law was to remove in the future the inability of the banks to increase their note-issues in an emergency, such as was disclosed in the panic of 1907. And it must be admitted that in a measure this end has been accomplished, although by means clumsy and not expected by the framers

[1] Theodore Gilman, "The Aldrich-Vreeland Bill," *North American Review*, August, 1908.

of the law. The law enables a bank which has already outstanding notes secured by United States bonds to an amount equal to 40 per cent. of its capital, and which has a surplus of 20 per cent., to take out additional circulation either (1) on certain bonds other than United States bonds, or (2) on any securities, including commercial paper, held by a national banking association. In (1) the bank can deal directly as an individual with the Treasury. In (2) the bank must act through a national currency association created by this law.

The preliminary requirement that no bank can issue additional circulation unless it has already outstanding notes secured by United States bonds equal to 40 per cent. of its capital is one that must be carefully reckoned with. It is a part of the persistent adherence to a bond-secured note-issue; and is supposed to be a measure of a transitional character on the way to some new basis of security. This provision, however, seems to ignore the character of the business done by the largest city banks. In the past their loan and deposit functions have been chiefly exercised through checks on deposits, and actual notes have been little called for in large transactions. Possibly the needs of country correspondents may have somewhat increased an otherwise small issue of notes by banks of the largest size; but, only in the recent panic, have these large banks resorted to any considerable issue of notes. Therefore, if there should be a general desire to put themselves in a position to issue additional notes under this act, the banks would certainly greatly increase the demand for United States bonds. July 31, 1908, there were deposited to secure circulating notes, United States bonds to the amount of $629,432,420; and to secure public deposits, $145,869,372; while the total issue of bonds outstanding (including $14,086,500, 3 per cent. certificates of indebtedness issued November, 1907) June 20, 1908, was $897,503,990. There is thus very little leeway for increasing notes secured by United States bonds, in view of the considerable amounts of these bonds held permanently by private investors. Now it is for the very reason that these bonds are high and scarce—how scarce, can well be appreciated by those who tried to borrow them in the recent crisis of 1907—

that the banking system required overhauling. And yet the first effect of the act will be to send up the price of government bonds, already, perhaps, 20 points higher than they would be but for the demand for them as security for bank notes. It is a serious question whether the obstacle of a large previous investment in United States bonds may not prevent the hoped-for ease of expansion in times of emergency. It will certainly be a heavy handicap; and it is one more illustration of the failure by the present act to meet the real difficulties of our present banking situation. If an emergency were to arise, the banks would no doubt resort, as before, to the issue of Clearing House Certificates.

1. In case a bank has satisfied the requirement as regards circulation based on United States bonds, then it may secure additional circulation based on other than United States bonds, by making application directly to the Comptroller of the Currency, and without the intervention of any currency association. Notes may be issued to the amount of 90 per cent. of the market value of these bonds, and are limited, all told, to the amount of a bank's capital and surplus. The kind of bonds allowed is clearly described (Section 3) as follows:

> Bonds or other interest-bearing obligations of any state of the United States, or any legally authorized bonds issued by any city, town, county, or other legally constituted municipality or district in the United States which has been in existence for a period of ten years, and which for a period of ten years previous to such deposit has not defaulted in the payment of any part of either principal or interest of any funded debt authorized to be contracted by it, and whose net funded indebtedness does not exceed ten per centum of the valuation of its taxable property, to be ascertained by the last preceding valuation of property for the assessment of taxes.

2. But should a bank wish to make use of its commercial assets as a basis for its circulation, it must act through a national currency association. Such a voluntary association, modeled somewhat after the plan of a clearing-house association, must contain not less than 10 banks, having an aggregate capital and surplus of at least $5,000,000. To it is given legal corporate powers. Only one association may be formed in any one city; and no bank may belong to more than one association. The

banks must be taken from contiguous territory. Any duly qualified bank, on application to the Secretary, can force its entrance into an association, and have all the rights of an original member. Thus, banks in New Jersey, or Connecticut could insist on membership in the Association of New York City, under the literal interpretation of "contiguous territory" given by Secretary Cortelyou. An association is governed by a board in which each bank has one vote. Thus a bank with a capital of $25,000 has equal influence with one having a capital of $25,000,000. and it has been discovered that no provision exists in the law by which a bank having once entered can ever withdraw from an association. This evidence of carelessness in drawing up the act has caused great hesitation and delay in the formation of associations. At this writing, that, in Washington, D. C., is the only one yet formed. Influential banks, held jointly liable with small banks for the redemption of any notes authorized by the association are slow to enter a combination from which they cannot withdraw in case of bad management. Once in, a bank cannot, during the six years of the act, withdraw even in order to take out notes as an independent bank dealing directly with the Treasury. This awkward situation is certain to call out an amendment next winter.

Supposing the difficulties connected with the forming of currency associations and the investment in United States bonds are surmounted, then we are face to face with the new methods of issuing additional notes based on banking paper. The provisions concerned with the basis of security are so pivotal, and so likely to be differently interpreted that it is well to quote them herewith. Indeed, the greatest surprise of the act is probably to be found in the crudeness, or haste, with which the law was framed on these points:

SEC. I. The national currency association herein provided for shall have and exercise any and *all powers necessary* to carry out the purposes of this section, namely, *to render available,* under the direction and control of the Secretary of the Treasury, as a basis for additional circulation *any securities, including commercial paper, held by a national banking association.* For the purpose of obtaining such additional circulation, any bank belonging

to any national currency association, having circulating notes outstanding secured by the deposit of bonds of the United States to an amount not less than 40 per centum of its capital stock, and which has its capital unimpaired and a surplus of not less than 20 per centum, may deposit with and transfer to the association, in trust for the United States, for the purpose hereinafter provided, such of the securities above mentioned as may be satisfactory to the board of the association. The officers of the association may thereupon, in behalf of such bank, make application to the Comptroller of the Currency for an issue of additional circulating notes to an amount not exceeding 75 per centum of the cash value of the securities or commercial paper so deposited. The Comptroller of the Currency shall immediately transmit such application to the Secretary of the Treasury with such recommendation as he thinks proper, and if, in the judgment of the Secretary of the Treasury, business conditions in the locality demand additional circulation, and if he be satisfied with the character and value of the securities proposed and that a lien in favor of the United States on the securities so deposited and on the assets of the banks composing the association will be amply sufficient for the protection of the United States, he may direct an issue of additional circulating notes to the association, on behalf of such bank, to an amount in his discretion, not, however, exceeding 75 per centum of the cash value of the securities so deposited: *Provided,* That upon the deposit of any of the State, city, town, county, or other municipal bonds, of a character described in section three of this Act, circulating notes may be issued to the extent of not exceeding 90 per centum of the market value of such bonds so deposited; *And provided further,* That no national banking association shall be authorized in any event to issue circulating notes based on commercial paper in excess of 30 per centum of its unimpaired capital and surplus. The term "commercial paper" shall be held to include only notes representing actual commercial transactions, which when accepted by the association shall bear the names of at least two responsible parties and have not exceeding four months to run.

In these words we have the final outcome of the whole struggle between those in favor of securing notes only by bonds and those in favor of securing them by commercial assets. If United States bonds were no longer to be the sole security, then a bond-secured circulation could be maintained by accepting other than United States bonds as a basis. This was the policy of the Aldrich Bill. Senator Aldrich opposed absolutely any issue of notes based on the current assets of banks, and insisted on a bond-secured currency, or nothing. Only when the House leaders were unable to pass the Aldrich Bill in the House, as already

explained; when it looked as if the party must go before the country confessing its impotence to pass any kind of a banking law; and only when some recognition of assets as security became essential to the passage of a bill through the House, did Senator Aldrich reluctantly yield. Even then he obviously intended to restrict the use of bank assets within the lowest possible limits. Undoubtedly he thought he had allowed only "commercial paper," as specifically defined in the act, to be used as security, together with other than United States bonds. Then it was that Mr. Vreeland drew up his bill, with an evident understanding with the Senate leaders on this point. In fact, the wording of the Vreeland Bill on this matter is the same as the wording of the present act—which was the outcome of the conference between the two Houses.

Now we have here what must undoubtedly prove a surprise both to Senator Aldrich and to the banking public, who naturally supposed that the law incorporated the purport of the compromise. As a matter of fact, the intention of Senator Aldrich was not expressed in the law as passed, whether from ignorance of English or of the character of banking paper, it is hard to say. Moreover, the manner of making the error is probably due to his zeal in trying to include railway bonds in the general class of those other than United States bonds. It will be remembered that the Aldrich Bill included in this class:

> the first-mortgage bonds of any railroad company, which, in compliance with existing law, reports regularly to the Interstate Commerce Association a statement of its condition and earnings, and which has paid dividends of not less than 4 per centum per annum regularly and continuously on its entire capital stock for a period of not less than five years previous to the deposit of the bonds (Section 2).

Owing to the political clamor against the railways, Senator Aldrich had to see this provision expunged from his bill. But when the bills of the two houses were in conference, it was possibly not noticed that the original phraseology of the Vreeland Bill, and as finally enacted, allowed "any securities, including commercial paper, held by a banking association" to be used as security under the direction of the Secretary of the Treasury. "Any securities"

includes not only first mortgage railway bonds, but any of the $16,000,000,000 of railway securities which may be held by any banking association, and accepted by the Secretary. Nor are any reports to the Interstate Commerce Commission necessary, nor the payment of dividends, as mentioned in the Aldrich Bill. And already the Secretary is confronted with the awful responsibility of deciding which of all these multifarious railway securities he ought to accept. It is a condition of things highly satisfactory to politicians and to bond dealers. If a security is accepted by the Secretary every national bank will be informed that it is good security for bank notes. Such action will give a bond or stock a valuable indorsement and greatly enhance its value. It opens up unlimited possibilities for pressure. It is an intolerable and an unforeseen situation.

But the inclusion of railway securities, by the words "any securities" has really introduced the greatest surprise of all into the new law. Without a shadow of doubt the language used is so broad and sweeping that it allows the banks to offer any assets held by them, other than "commercial paper," as specifically defined in the act, and to which it was generally supposed the banks were limited. The very pains taken to define "commercial paper" would lead one to suppose that only that description of paper would be accepted. Such, however, is not the law. The act, as already quoted, runs as follows:

> The national currency association herein provided for shall have and exercise any and all powers necessary to carry out the purposes of this section, namely, to render available, under the direction and control of the Secretary of the Treasury, as a basis for additional circulation *any securities*, including commercial paper, held by a national banking association.

The powers here granted are sweeping; and the purpose of granting these large powers is defined to be: to render available as a basis for additional circulation any securities (including one specified kind) held by a national bank. The words "any securities" are used as a general or generic term, covering not only bonds, but such securities as commercial paper. Obviously, as the language runs, the words include any thing other than "commercial paper" which could properly be included under "any

securities." The interpretation hinges upon the meaning of the word "securities." In the accounts of the Bank of England the term employed to cover all loans to customers is "other securities." In fact, in American banking usage, the word securities is commonly applied to any of the notes, collateral, or other paper, held to secure the repayment of a loan. It is a generic term.

The word "securities" is possibly not used with precision in the act. Clearly, it is not intended to be made synonymous only with bonds. After making the general statement about "any securities, including commercial paper," the act speaks of the deposit, in trust for the United States, of "such of the securities above mentioned as may be satisfactory to the board of the association." Here securities include, of course, commercial paper. Again, in Section 1, the word appears generically as follows:

> If he [the Secretary] be satisfied with the character and value of the securities proposed, and that a lien in favor of the United States on *the securities so deposited* and on the assets of the banks composing the association will be amply sufficient for the protection of the United States, etc.

Here, the context shows that the word "securities" includes the discounted bank paper on which notes could be issued only to 75 per centum of "the cash value of the securities so deposited;" for this amount of 75 per centum is put in opposition to the 90 per centum of notes to be issued, if the basis furnished is made up only of bonds.

Again in Section 9, in regard to the tax, it is said:

> National banking associations having circulating notes secured otherwise than by bonds of the United States shall pay for the first month a tax at the rate of 5 per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax of 1 per centum per annum for each month until a tax of 10 per centum per annum is reached, and thereafter such tax of 10 per centum per annum, upon the average amount of such notes. Every national banking association having outstanding circulating notes secured by a deposit of other securities than United States bonds shall make monthly returns, under oath of its president or cashier, to the Treasurer of the United States, in such form as the Treasurer may prescribe, of the average monthly amount of its notes so secured in circulation; and it shall be the duty of the Comptroller of the Currency to cause such reports

of notes in circulation to be verified by examination of the banks' records. The taxes received on circulating notes secured otherwise than by bonds of the United States shall be paid into the Division of Redemption of the Treasury and credited and added to the reserve fund held for the redemption of United States and other notes.

Obviously, the tax is the same on notes based on bonds other than United States bonds, and on commercial paper. If so, the word "securities" is used generically to include both kinds of protection to the notes.

The act, then, permits the issue of notes on (1) United States bonds (2) on approved bonds other than United States bonds, and (3) on "any securities, including commercial paper, held by a national banking association." It distinctly does not confine the issue of notes under (3) only to commercial paper—although it defines commercial paper specifically; and although it provides, in Section 1,

That no national banking association shall be authorized in any event to issue circulating notes based on commercial paper in excess of 30 per centum of its unimpaired capital and surplus.

What then is the meaning of "any securities," other than "commercial paper"? Possibly Congress meant to separate the class of bonds distinctly from the class of "commercial paper," and to use securities only as a synonym for bonds. Under this supposition, notes could be based only on (1) United States bonds, (2) other approved bonds, and (3) commercial paper, as defined. If, however, this was the intention, it was certainly not so expressed in the law. For, as we have seen, "securities" is not synonymous with bonds; and any securities other than bonds are permitted, including "commercial paper."

Why, then, was commercial paper defined, and the issues based upon them limited to 30 per cent. of the capital and surplus? The definition is as follows:

The term "commercial paper" shall be held to include only notes representing actual commercial transactions, which when accepted by the association shall bear the names of at least two responsible parties and have not exceeding four months to run.

Possibly, it was the intent of Congress that the only bank paper on which notes could be based was commercial paper; but,

irrespective of this definition and of the 30 per cent. clause, a currency association is given "any and all powers necessary . . . . to render available . . . . as a basis for additional circulation *any securities, including commercial paper, held by a national banking association.*" As the law stands, if the association is limited to 30 per cent. of its capital and surplus, when presenting "commercial paper," it is not so limited if it presents other bank paper not classifiable as "commercial" under the definition. In truth, those assets of a bank which do not come under the definition of "commercial paper" are given more liberal treatment than "commercial paper," and are placed outside of the operation of the 30 per cent. clause.

Undoubtedly, some members of Congress must have thought they had shut off the issue of notes on all assets (exclusive of government, or other bonds), except commercial paper. They probably wanted to distinguish between "accommodation paper," or "finance bills," on the one side, and legitimate commercial paper, on the other. But the sweeping general clauses of the act do not confine the securities other than bonds to commercial paper, as defined in the act. The wording of the law has left the gates wide open for the deposit of any securities (i. e., any kind of paper) held by a national bank, and offered by a currency association, subject only to "the direction and control of the Secretary of the Treasury." At least, that is the only possible interpretation which, in my opinion, must be given by the courts. And these are the reasons for the previous statement that the law has provided the means for a large expansion of notes in a time of emergency—a freedom quite unexpected by advocates of asset-currency. Moreover, the House is put in control of the situation; for, if an attempt is made by the Senate to amend its mistakes, the House, in which there is a majority against bond-secured circulation, can retain the present law. Any repeal, or amendment requires the consent of the House. This is certainly a startling outcome of the currency struggle.

The new law introduces some difficulties before additional notes can be issued; but after that point is reached the gates are certainly left wide open. In case of such a panic as that of 1907,

the scramble for currency would have been avoided, the reserves protected more or less, the resort to clearing-house checks for currency in daily use prevented, and a sense of insecurity due to inability to get currency would have been removed, had this Aldrich-Vreeland Act—as interpreted above—been in force. Of course, it would not prevent a future panic. No act could do that.

In addition, the notes will be perfectly safe. The banks must keep in the redemption fund (Section 6) a sum equal to 5 per cent. of its additional circulation (other than that based on United States bonds), as distinct from the original 5 per cent. redemption fund of June 20, 1874. Thus it would seem that for notes secured by United States bonds, only 5 per cent. is required, but, for all notes otherwise secured, 10 per cent. The Treasury is obliged to redeem the notes; but, besides the securities deposited, the Treasury can have recourse upon all the assets of the banks in a currency association. The taxes paid, moreover, are to be turned into the Division of Redemption and added to the reserve fund held for the redemption of United States and other notes, thus constituting a potential safety fund in the future.

Also, banks must pay a uniform rate of interest throughout the country of at least one per cent. on government deposits; but no reserves need be held against such deposits. Nor are any reserves against notes required.

V

The Aldrich-Vreeland Act in its attempt to define "commercial paper," thus opens up the whole question as to the nature and classification of banking assets. The contemptuous rejection by the leaders, of all advice from bankers has undoubtedly got the framers of the law into unsuspected difficulties.

If only "commercial paper" as defined in the act were accepted, then there would be excluded all loans based on legitimate transactions bearing only one name. Thus the notes of H. B. Claflin & Co., or the U. S. Steel Corporation, would be excluded. The sale of goods would thus be no basis for a discount, unless such a firm went out and obtained another name. Such a discrimina-

tion is not only unfair, but it ignores the actual trade methods in this country.

Practically, the only way in which two-name paper, based on actual transactions, is presented for discount in this country, is that in which so-called "trade-paper" is created. When a merchant buys goods in the United States on time, he receives a greater or less discount for paying cash before the account is due. This discount varies in different trades. In groceries, food products, etc., the sales are usually on 10 days time, and the discounts play no real part. In the sale of luxuries, such as fine millinery, or jewelry, the period allowed for payment of goods may be six months. But in trades like hardware, the time runs from 30 to 90 days. Hence, if a discount of 3 per cent. is allowed by the seller, if cash is paid in 10 days on goods sold at 90 days credit, that is equivalent to 3 per cent. for 80 days, or at a rate of 13½ per cent. per annum. Likewise, a discount of 2 per cent. for cash paid in 30 days is equal to 12 per cent. per annum. Now, if the buyer has good standing he can borrow at 4 or 5 per cent., and pay off his account, thereby saving the difference between 4 or 5 and 12 or 13½ per cent. The longer the time on which goods are sold, the larger the discounts and the greater the inducement to borrow and to anticipate payment of the account. Consequently, the merchants having the best credit never wait until their accounts mature; some of poorer credit meet payment at maturity; and others, not able to pay when the accounts fall due, must borrow and meet one indebtedness by creating a new one. Now, this last class, the poorest of all, create two-name paper, based on actual transactions, on less than four-months time usually, and would be technically acceptable as "commercial paper" security for note-issues; while the paper of the men of higher credit, who can always borrow and save on the trade discounts, would not be acceptable. The framers of the act were lamentably ignorant of American trade methods and the nature of banking paper. In fact, the definition of "commercial paper" pivots mainly on the requirements of two names. But it is obvious that this requirement would rule out some of the best paper now held by banks.

In order to get a clear idea of the kind of assets held by national banks, having chiefly a mercantile clientele, the following classification given to the Comptroller by a certain well-managed bank will give us the average condition of such institutions:

A.	On demand, paper with one or more individual or firm names	$2,231,184.06
B.	On demand, secured by stocks, bonds, and other personal securities	4,063,083.61
C.	On time, paper with two or more individual or firm names	8,350,629.34
D.	On time, single name paper, one person or firm without other security	9,497,384.44
E.	On time, secured by stocks, bonds, and other personal securities	5,604,183.75
F.	Secured by real estate, mortgages, or other lien on real estate	28,820.00
		$29,775,285.20

Apparently, according to the definition in the Aldrich-Vreeland Act of the paper allowable as security for notes, through currency associations, only class C could be accepted, and only that part which could be strictly construed as based on actual transactions. Yet, according to bankers, this is not as a rule the best banking paper held.

As every one knows, also, the banks dealing mainly in loans of a mercantile character are large buyers of paper sold by note brokers. Such notes are rarely secured by collateral, and usually bear one name. In the case of large corporations the indorsement of more than one officer of the company could not make two-name paper. In spite of some faults in such loans—doubtless remediable—the extent of the dependence on note brokers is widespread. The situation is well expressed by a prominent banker[2] as follows:

The ease with which loans are obtainable in normal times by responsible houses on their own direct, unsecured obligations, through the agency of note brokers, has nearly done away with trade paper [i. e. two-name commercial paper] of the highest grade. All good concerns and many even in second and third grade credit are enabled to borrow all the funds required

[2] Joseph T. Talbert, president of the Chicago Clearing House, *Commercial Credits,* an address before the New York State Bankers' Association, July 10, 1908.

to take advantage of trade discounts, and enough more to meet all other bills at maturity, so there is little or no reason to settle trade accounts by notes. . . . . No house can habitually do so without ultimate damage to its credit. The business of the note broker in directly supplying capital when needed by solvent borrowers for production use in trade is comparatively a modern occupation, and it is highly beneficial if confined within legitimate and prudent limits. In this country the business has developed enormously within two or three decades and along lines that were unthought of a few years ago and which then would have been deemed impossible and extremely hazardous. The system as we know it is not in common practice anywhere else in the world.

All such paper obviously would be excluded by the legal definition of "commercial paper."

The loans of modern banks are, of course, of all kinds; but a rough division may be made as follows: (1) loans to customers of a mercantile character; (2) notes purchased of note brokers; and (3) loans to stock brokers and individuals. The last class (3) are usually demand loans, and are generally fully secured and quite safe, being margined on quickly salable securities. Therefore, if only "commercial paper," as defined, were accepted as security for notes, classes (2) and (3) and a large part of (1) would be refused. Yet, in the report of the New York Clearing House Association for the period from October 26, 1907, to March 28, 1908, during which the gross issue of certificates during the panic conditions was $101,060,000, collateral of the classes of assets mentioned above, was used as security for the issue of certificates, to the amount of $330,000,000 or 72.92 per cent. of all securities; and yet not a dollar was lost in that whole time of crisis and danger.

In conclusion, if the loose wording of the act is interpreted as I have claimed—and no other seems possible—the banking paper which does not come under the legal definition of "commercial paper" must be accepted as security for notes; it must be accorded the same treatment as any securities (other than United States bonds) held by a banking association; the amount of notes issuable on such banking paper (other than "commercial paper") is not limited to 30 per cent. of the capital and surplus; and notes can be issued to the amount of 75 per cent. of the

market value of those securities. The valuation of the securities, whether bonds, or banking paper, and the decision as to which shall be accepted, all finally rests with the Secretary of the Treasury. What a paradise for the climbing politician. Already he has been active in obtaining government deposits for banks in his district; and, now he will have new worlds for conquest in pressing local securities upon the magic list of the Treasury which is to give them a new value and advertisement at no cost. Certainly, we have in this Aldrich-Vreeland Act—the product of a few days struggle at the end of the session—an unexpected freedom of issues based on banking assets, as well as a Pandora's box full of unknown possibilities for evil. It is an amazing lesson on the folly of politics in banking.

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